Supreme Court, U.S.
FILED

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No. 03-___

IN THE

Supreme Court of the United States

Marvin and Lynn St. Germain, *et al.*,
Petitioners,

v.

U.S. Home Corporation

On Petition for a Writ of Certiorari
to the Supreme Court of California

PETITION FOR WRIT OF CERTIORARI

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January 13, 2003

QUESTIONS PRESENTED

1. Is application of the provisions of the Federal Arbitration Act valid as to an intrastate contract for the sale of new residential properties when the only conceivable connection to interstate commerce is long ago completed construction activity?

2. Does application of the provisions of the Federal Arbitration Act to a contract evidencing a transaction involving the sale of a completed home invade the province of traditional and primary powers of the State of California to regulate housing and construction such that the Federal Arbitration Act should not be given preemptive effect?

3. Does the principle of *stare decisis* require continued adherence to the Court's holding in *Southland Corp. v. Keating*, 465 U.S. 1 (1985) as to the application of the provisions of the Federal Arbitration Act to actions filed in state courts?

PARTIES TO THE PROCEEDINGS BELOW

In addition to the parties named in the caption, the following parties appeared below and are petitioners here: Charles and Monica Stansell, Salvatore and Tula Coco, Marian and Maria Olesky, Wayne and Dianna Martin, Saundra Dendy, Lawrence and Dena Brown, Anthony and Vicki Bonofiglio, Keith and Penny Davis, John and Yolanda Fullinwider, Kevin Tierney and Camille Reineke, Alberto and Victoria Garcia, Gary and Cynda Jerger, Assador and Valentine Farajian, Suzy Farajian, Arpy Farajian, Robert Vergura, Amy Workman, Michael Brown, Dena Brown, David Brown, Monica Stansell, Monique Stansell, Chanel Stansell, Victoria Garcia, Christian Garcia, Nourit Vergura, Robert Vergura, Noah Vergura, Chanelle Vergura, and Patricia McLaughlin. In addition, the following parties appeared below and are cross-defendants here: Abubo Concrete, Inc.; Geosoils, Inc.; Bruce B. Keith Architect; Commanche Concrete, Inc.; and Maddox Concrete.

STATEMENT PURSUANT TO RULE 29.6

No corporate entities are petitioners herein.

RULE 29.4(C) CERTIFICATION

Petitioners certify that 28 U.S.C. 2403(b) does not apply and that this Petition does not need to be served upon the Attorney General of California.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Marvin Jr. and Lynn St. Germain, *et. al.* respectfully petition for a writ of certiorari to review the decision of the Supreme Court of California in this case.

OPINIONS BELOW

The opinion of the Supreme Court of California (Pet. App. 1a) is unpublished. The opinion of the Court of Appeal of California (Pet. App. 2a) is unpublished. The order of the Superior Court granting respondents' motion to compel arbitration and to stay action (Pet. App. 3a-7a) is unpublished.

JURISDICTION

The Supreme Court of California denied review (Pet. App. 1a) on October 16, 2002. This Court has jurisdiction under 28 U.S.C. 1257(a).

RELEVANT CONSTITUTIONAL AND STATUTORY PROVISIONS

Article 1, § 8, cl. 3 of the Constitution provides in relevant part: "Congress shall have Power to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." The relevant provisions of Federal and California law are reproduced in the appendix (Pet. App. 29a-45a).

STATEMENT OF THE CASE

This matter involves two consolidated actions relating to eighteen (18) residential real properties and homes in a tract development commonly known as the Woodbridge Development located in Corona, California. Defendants U.S. Home Corporation et. al. ("U.S. Home")

asserting that all claims alleged by the Plaintiffs ("Home Buyers") must be submitted to arbitration based on provisions within its original Sales Agreement and separate Limited Warranty, filed a motion to compel arbitration and stay proceedings in Superior Court for the County of Riverside, on unspecified jurisdictional grounds. Home Buyers opposed compelled arbitration.

In addition to claims asserted against U.S. Home, Home Buyers named and served numerous other parties who were not signatories to the arbitration agreement, including design professionals and subcontractors. One subcontractor filed a cross-complaint against U.S. Home.

The pertinent provision, Section 14(B) of the Sales Agreement provides, in part:

> 14. ARBITRATION OF DISPUTES.
> (B) ARBITRATION OF ALL OTHER CLAIMS AND DISPUTES. BY PLACING THEIR INITIALS HERE, BUYER /S/ AND SELLER /S/ AGREE THAT: Any controversy or claim arising under or related to this Agreement or to the Property . . . or with respect to any claim arising by virtue of any representations alleged to have been made by the Seller or Seller's representatives SHALL BE SETTLED AND FINALLY DETERMINED BY MEDIATION OR BINDING ARBITRATION AS PROVIDED BY THE FEDERAL ARBITRATION ACT (9 U.S.C. SECTION 1-14). AND SIMILAR STATE STATUES AND NOT BY A COURT OF LAW. The claim will first be mediated in accordance with the Commercial Mediation Rules of the American Arbitration Association. If not resolved by Mediation, the claim will be settled in accordance with the Commercial Arbitration rules of the American Arbitration Association....

Home Buyers contended in their opposition to the motion to compel arbitration that:

1. The subject dispute did not invoke the Commerce Clause;
2. The Magnuson-Moss Act, 15 U.S.C. §2311(c)(2) allows the states to afford consumers protection;
3. The action should have been stayed pursuant to Cal.Code Civ. Proc. § 1281.2, due to the inclusion of non-signatories to the contract, pursuant to *Volt Information Sciences, Inc. v. Trustees of Leland Stanford Junior Univ.*, (1989) 489 U.S. 468;
4. The contract did not evince an intention to arbitrate and/or was ambiguous; and
5. Fraud and unconscionability barred the compelling of arbitration. (Pet. App. 8a-14a).

The Superior Court granted the motion to compel arbitration and stay the action on [generally] the following grounds (Pet. App. 3a-7a):

1. Based on the contracts and warranties, the original purchasers agreed to arbitrate all their disputes;
2. The subsequent purchasers were bound to the terms of the contract as third party beneficiaries;
3. Minors and tenants are bound by the terms of the warranty as they are claiming its benefits;
4. The Federal Arbitration Act is controlling and inconsistent California statutes are preempted;
5. *Volt, supra*, 489 U.S. 468 is not on point because the parties expressly chose to arbitrate their claims under the FAA;
6. The arbitration contracts are not unconscionable; and
7. The arbitration clauses include both contract and tort actions.

Home Buyers subsequently filed a petition for writ of mandate or prohibition in the Court of Appeals of the State of California, Fourth District, Division Two. Home Byers contended that relief by extraordinary writ was

required in that they were being deprived of their right to trial by jury and right to appeal, and that the lower court erred in the following respects:

1. The court should have denied the motion to compel in order to avoid inconsistent results as to the numerous parties who were not subject to the terms of the contracts, pursuant to *Volt, supra,* 489 U.S.468;
2. The subject dispute did not invoke the Commerce Clause;
3. The court should not have compelled the subsequent purchaser plaintiffs, minors, and non-owners to arbitrate;
4. The court failed to find that the arbitration provisions were adhesive and unconscionable such that they could not be enforced. (Pet. App. 15a-22a).

The Court of Appeals summarily denied the writ, and Home Buyers promptly petitioned the California Supreme Court for Review. The questions present for the Petition for Review included:

A. Whether California law relating to arbitration is preempted when the sales agreement contains a provision referencing both the FAA and California law;
B. Whether litigation involving construction defects in homes, which are primarily used for residential purposes, invoke the Commerce Clause;
C. Whether the arbitration clauses are unconscionable;
D. Whether non-signatories to the sales agreements should be compelled to arbitrate their disputes. (Pet. App. 23a-28a).

The California Supreme Court summarily denied the Petition for Review on October 16, 2002.

REASONS FOR GRANTING THE WRIT

The Petition for Writ of Certiorari should be granted for two principal reasons. First, the California Supreme Court's ruling, in denying the Petition for Review, leaves intact the Superior Court decision compelling arbitration pursuant to the Federal Arbitration Act, in contradiction to this Court's precedents in analyzing whether or not a contract or transaction involves interstate commerce. The contracts at issue do not "evidence contracts involving interstate commerce" within the meaning of 9 U.S.C. § 2. There are no known United States Supreme Court cases interpreting this language in the context of contractual actions based on defects in fully completed new residential development homes, and very little guidance from state court cases regarding this important issue, involving not only Home Buyers in the instant action, but millions of home buyers nationwide. The California Supreme Court decided, by denying petition for review, that such sales do involve interstate commerce, resulting in invalidating state law prohibiting enforcement of arbitration clauses in construction defect cases. This important question should be decided by the United States Supreme Court. A completed home does not cross state lines and there is no interstate activity involved in the sale of the homes in the State of California. Thus, preemption of California state law prohibiting the enforcement of arbitration clauses in construction defect cases should not be preempted by the FAA.

Second, the Court should re-examine its decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), in which the Court first applied the provisions of the FAA to actions filed in state courts for two reasons. As set forth in numerous dissents and concurrences in *Southland* and its progeny, application of the FAA in state court actions is not in accord with the legislative intent of the Act.

Furthermore, recent developments, including the Court's emerging Commerce Clause jurisprudence as manifested in *United States v. Lopez*, 514 U.S. 549 (1995) and *United States v. Morrison* 529 U.S. 598 (2000), justify re-evaluation of the Court's holding in *Southland*. Creation of confusion in state courts due to post-*Southland* Supreme Court decisions is not the only problem created by *Southland* and its progeny. As Justice Breyer surmised in *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265 (1994), "parties" [consisting exclusively, in the case of construction defect cases, of (usually) large development companies] have been relying on *Southland* to specifically craft their adhesive sales agreements to encompass arbitration under the FAA. Homebuyers do not draft sales agreements, and have no effective ability to negotiate them. The end effect of adhering to *Southland* will be more litigation in state courts regarding the purported unconsciousability of such agreements.

I. PRIOR INTERSTATE ACTIVITY DOES NOT BRING A CONTRACT WITHIN THE AMBIT OF THE COMMERCE CLAUSE SUCH AS TO PREEMPT CALIFORNIA LAW INVALIDATING ARBITRATION CLAUSES IN CONSTRUCTION DEFECT ACTIONS.

California consumers, specifically buyers of new homes, should not be deprived of protection of their rights under California law to trial by jury and right of appeal in actions involving construction defects in their homes, due to an invalid application of the provisions of the Federal Arbitration Act ("FAA.") Cal. Code Civil Proc. §1298.7 provides that arbitration clauses are unenforceable in actions based on defects in

construction of homes.[1] This provision is preempted by

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[1] California Code of Civil Procedure section 1298.7 provides: "In the event an arbitration provision is included in a contract or agreement covered by this title, it shall not preclude or limit any right of action for bodily injury or wrongful death, or any right of action to which Section 337.1 or 337.15 is applicable."

California Code of Civil Procedure section 337.1 provides in pertinent part:

> **"Four years; actions for damages from persons performing or furnishing design, specifications, surveying, planning, supervision or observation of construction or construction of improvement to realty**
> (a) Except as otherwise provided in this section, no action shall be brought to recover damages from any person performing or furnishing the design, specifications, surveying, planning, supervision or observation of construction or construction of an improvement to real property more than four years after the substantial completion of such improvement for any of the following:
> (1) Any patent deficiency in the design, specifications, surveying, planning, supervision or observation of construction or construction of an improvement to, or survey of, real property."

California Code of Civil Procedure section 337.15 provides in pertinent part:

> **"Ten years; developer, contractor, architect, etc. of real property; latent deficiency in design, supervision, etc.; injury to property**
> (a) No action may be brought to recover damages from any person, or the surety of a person, who develops real property or performs or furnishes the design, specifications, surveying, planning, supervision, testing, or observation of construction or construction of an improvement to real property more than 10 years after the substantial completion of the development or improvement for any of the following:

the FAA only if the contracts at issue involve interstate commerce. They do not.

Article 1, § 8, cl. 3 of the Constitution provides that "Congress shall have Power to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." No "Commerce among the several States" is implicated in the Sales Agreements executed by the purchasers of new homes in this action

The Court has established that the phrase "involving interstate commerce,"as set forth in 9 U.S.C. § 2[2] is equivalent to "affecting commerce." *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 273-274 (1995). However , this effect must be more than "trivial," it must be "substantial." *United States v. Lopez* 514 U.S. 549, 559, (1995). Actions involving construction defects discovered long after the completion of the labor and supply of the materials do not implicate ***any*** concerns involving interstate commerce, let alone substantial effects. Home Buyers in this matter are not asking, in their contract-based causes of action, for the developers and contractors to fix the homes, or to compensate them for labor or services provided under a contract, but, rather, to compensate them for defects in buildings completed long ago. Pursuant to 9 U.S.C. 2, the Act applies only to a "***contract*** evidencing a transaction involving

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(1) Any latent deficiency in the design, specification, surveying, planning, supervision, or observation of construction or construction of an improvement to, or survey of, real property."

[2] 9 U.S.C.§ 2 provides: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . .shall be valid, irrevocable, and enforceable save as upon such grounds as exist at law or in equity for the revocation of any contract."

interstate commerce." The focus should be on the nature of the contracts themselves, which in this case, and in many construction defect cases, involve intrastate sales of fully completed homes, at least as to the original purchasers, who, in the instant case, are the only ones pursuing contractually based claims.[3] Previous activity involved in building the homes, while it may have been involved in contributing to the defects, is not the basis for actions based on contracts involving the delivery of fully constructed residential homes. Thus, contracts between developers or sellers of new homes and the buyers do not constitute contracts ***evidencing*** a transaction involving interstate commerce. There is no ongoing or future conduct involved. A contract for the sale of a completed home in the State of California does not involve working in interstate commerce, purchasing products through interstate commerce, or engaging in any activity that affects interstate commerce in any way.

The Court in *Lopez* determined that a federal statute involving possession of a gun in a school zone was not a valid exercise of federal power under the Commerce Clause. Although it is a certainty that a gun is an end product of interstate production (as are residential homes), the *Lopez* Court pointed out that the mere fact that the end product itself may have had a commercial origin is not controlling:

> In a sense any conduct in this interdependent world of ours has an ultimate

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[3] Home Buyers additionally contended in proceedings below that the intent of the parties was to be subject to California law, and that pursuant to *Volt Information Services, Inc. v. Board of Trustees of Leland Stanford Junior University* 489 U.S. 468, the action should be stayed pursuant to Cal. Civ. Proc. Code section 1281.2(c) on the basis that certain parties to the action, including subcontractors and subsequent purchasers, were not bound by the terms of the Sales Agreement.

> ***commercial origin*** or consequence, but we have not yet said the commerce clause may reach so far." *United States v. Lopez* (1995) 514 U.S. 549, 580 (Kennedy, J., concurring)(emphasis added). *See also, United States v. Morrison*, 529 U.S. 598, 611, citing this language with approval.

Significantly, none of the two extensive dissenting opinions takes issue with this proposition, or suggests in any way that the interstate origin of a gun could be a factor in the analysis.[4]

The Court has previously considered a situation in which goods from out of state had come to rest in a state. In *A.L.A. Schecter Poultry Corp. v. United States* 295 U.S. 495 (1935) the court struck down a conviction for violations of regulations fixing the hours and wages of employees of an intrastate poultry business. As summarized by Justice Thomas, *Schecter* held that "Congress may not regulate intrastate sales of sick chickens or the labor of employees involved in intrastate poultry sales) *Lopez, supra,* 514 U.S. at 599 (Thomas, J., concurring). In *Schecter,* the Court analyzed the regulation in regard to two aspects, as to whether the transactions for which the defendants were convicted were "*in*" interstate commerce, and as to whether they "directly affected" interstate commerce, in the sense of being within Congress's power to protect commerce. (*Schecter, supra,* 543 U.S. at 542, 544). The Court answered both questions in the negative. In holding

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[4] While Justice Stevens, in his brief dissenting opinion does state, "Guns are both articles of commerce and articles that can be used to restrain commerce. Their possession is the consequence, either directly or indirectly, of commercial activity," his following conclusions do not rest on this proposition, but, rather, upon the harmful use of guns. *Lopez, supra,* 514 U.S. at 602, Stevens, J. dissenting).

that when materials come to permanent rest within a State, interstate commerce had ceased and the continued power of federal regulation had terminated, the Court stated, in its analysis of "interstate commerce":

> The undisputed facts thus afford no warrant for the argument that the poultry handled by defendants at their slaughterhouse markets was in a "*current*" or "*flow*" of interstate commerce and was thus subject to congressional regulation. The mere fact that there may be a constant flow of commodities into a State does not mean that the flow continues after the property has arrived and has become commingled with the mass of property within the State and is there held solely for local disposition and use. So far as the poultry here in question is concerned, the flow in interstate commerce had ceased. The poultry had come to a permanent rest within the State. It was not held, used, or sold by defendants in relation to any further transactions in interstate commerce and was not destined for transportation to other States. Hence, decisions which deal with a stream of interstate commerce—where goods come to rest within a State temporarily and are later to go forward in interstate commerce—and with the regulations of transactions involved in that practical continuity of movement, are not applicable here.

Id. at 543 (citing *Swift & Co. v. United States, 196 U.S. 375, 388; Lemke v. Farmers Grain Co.*, 258 U.S. 50, 55; *Stafford v. Wallace*, 258 U.S. 495, 519; *Chicago Board of Trade v. Olsen*, 262 U.S. 1, 35; *Tagg Bros. & Moorhead v. United States*, 280 U.S. 420, 439).(emphasis in original).

In this respect, even though this part of the

analysis dealt specifically with the "in commerce" aspect, rather than the broader "involving commerce" focus, *Schecter* is in accord with current Commerce Clause jurisprudence, and remains valid law. The activity which could conceivably be construed as "involving commerce" had long ago come to an end, and is merely an example of a transaction of "commercial origin," which, alone, will not support the exercise of federal regulation under the Commerce Clause. *Lopez, supra*, 514 U.S. at 580 (Kennedy, J., concurring).

A. Regulation of Construction and Housing Constitutes an Exercise of the State's Traditional and Primary Powers Under the Police Power of the States.

The action at issue involves claims of defects in residential real property in the State of California, as well as claims of bodily injury arising from defects in these non-movable structures. The State of California has a compelling public interest in protecting the integrity of residential real property within its territory, and has promulgated statutes to safeguard these interests. *See, e.g. , Cal. Health & Safety Code* §§ 17921(a), 17957, 17995, 17995.1, 19825, 19826, and 19835; *Cal. Bus. & Prof. Code* §§ 5510, 5536, 6710, 7000.5, 7028, 7071.5; *IAPMO v. Cal. Building Standards Comm.* (1997) 55 Cal.App. 4th 245, 248 (stating: "There is no question that regulation of the building industry is an appropriate exercise of the state's police power"). In accordance with these local public concerns, the legislature of the State of California has enacted formal statutory protections that specifically provide for resolution of disputes regarding defects in residential real property in its own courts, and invalidate arbitration clauses involving these specifically protected local interests. *Cal. Code Civil Proc.* § 1298.7.

Justice Kennedy pointed out that in testing an

extension of power under the Commerce Clause, inquiry must be made as to "whether the exercise of national power seeks to intrude upon an area of traditional state concern." *Lopez, supra,* 514 U.S. at 580 (Kennedy, J. concurring). This same test should be employed in analyzing whether a contract evidences a transaction involving interstate commerce. As the Court pointed out in *Volt Information Services, Inc. v. Board of Trustees of Leland Stanford Junior Univ.* (1988) 489 U.S. 468, 477:

> The FAA contains no express pre-emptive provision, nor does it reflect a congressional intent to occupy the entire field of arbitration. See *Bernhardt v. Polygraphic Co.*, 350 U.S. 198 (1956) (upholding application of state arbitration law to arbitration provision in contract not covered by the FAA).

Therefore, the connection of interstate commerce to the contract is key, for without it, the FAA is of no effect whatsoever, and state law controls. In California construction defect actions, contract disputes do not involve interstate commerce. Therefore, California law should control, rendering arbitration clauses unenforceable, as intended by the California legislature in legislating in this field of traditional state concern. *Cal. Code Civ. Proc.* § 1298.7.

As Justice Thomas pointed out in *Lopez*, Chief Justice Marshall, in the seminal case of *Gibbons v. Ogden*, 22 U.S. 1, 9 Wheat. 1, 6, L.Ed. 23 (1824) "took great pains to make clear that Congress could *not* regulate commerce 'which is completely internal, which is carried on between a man and a man in a State, or between different parts of the State, and which does not extend to or affect other States.'" *Lopez, supra,* 514 U.S. at 594 (Thomas, J. concurring, citing *Gibbons, supra,* 9 Wheat. at 194, emphasis in original). As Justice Thomas further emphasized:

> Moreover, while suggesting the Constitution might not permit States to regulate interstate or

> foreign commerce, the Court observed that "inspection laws, quarantine laws, health laws of every description, as well as laws for regulating the internal commerce of a State' were but a small part 'of that immense mass of legislation . . . not surrendered to a general government." *Lopez, supra,* 514 U.S. at 594 (Thomas, J. concurring, citing *Gibbons, supra,* 9 Wheat. at 203).

Here, the transactions covered by *Cal. Code Civ. Proc.*§ 1298.7 (lawsuits based on contracts involving defects in housing) concern property damage, bodily injury claims and health and safety (building code) violations; the FAA covers only lawsuits based on contracts involving commerce. Thus, in this situation, application of the provisions of the FAA, which effectively require arbitration of disputes involving interstate commerce, is invalid.

Land-use regulation and such things as zoning regulation have been held to fall squarely within the police power of the states. *See Gorieb v. Fox,* 274 U.S. 603 (1927) (set-back requirements are legitimate exercises of state police power); *Solid Waste Agency of Northern Cook County v. United States Army Corps of Engineers,* 531 U.S. 159 (2001). In *Solid Waste,* the Court, in determining that the denial of a permit for development of a gravel pit for a solid waste disposal site was not authorized, did not reach the constitutional issue regarding the Commerce Clause, but specifically noted that such regulation would impinge on powers reserved to the states:

> Twice in the past six years we have reaffirmed the proposition that the grant of authority to Congress under the Commerce Clause, though broad, is not unlimited. See *United States v. Morrison,* 529 U.S. 598 (2000); *United States v. Lopez,* 524 U.S. 549 (1995). . . Permitting respondents to claim federal jurisdiction over

> ponds and mudflats falling within the "Migratory Bird Rule" would result in a significant impingement of the States' ***traditional and primary power*** . . . . *Solid Waste, supra*, 531 U.S. at 174 (emphasis added).

In *Jones v. United States* (2000) 529 U.S. 848, the Court analyzed the application of a federal arson statute, 18 U.S.C. §844(i)[5] to a conviction for arson of an "owner-occupied residence," holding that the arson of such a property "not used for any commercial purpose does not qualify as property 'used in' commerce or commerce-affecting activity." *Id.* at 859. Thus, arson of such a building does not fall within the "compass" of section 844(i). *Id.* at 850. The court noted that:

> Were we to adopt the Government's expansive interpretation of § 844(i), hardly a building in the land would fall outside the federal statute's domain. Practically every building in our cities, towns, and rural areas ***is constructed with supplies that have moved in interstate commerce***, served by utilities that have an interstate connection, financed or insured by enterprises that do business across state lines, or bears some other trace of interstate commerce.

Id. at 857 (emphasis added).

While the Court in *Jones* focused on the "used in commerce language," and did not reach the constitutional issue, nevertheless, its guidance as to the intrinsically non-commercial nature of an owner-

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[5] 18 U.S.C. § 844(i) "makes it a federal crime to 'maliciously damage or destroy,...by means of fire or an explosive, any building....used in interstate or foreign commerce or in any activity affecting interstate or foreign commerce.'" *Id.* at 850.

occupied residence is instructive. However, the Court's very holding, as expressed (i.e., that the property "did not qualify as property 'used in' commerce or commerce-affecting activity"), (*Id.* at 859) suggests that it would have found that, by the same criteria, the residential property did not constitute property "affecting commerce" in the broader constitutional sense, had it chosen to address the constitutional issue.[6]

The Court in *Jones* found the reasoning in *United States v. Mennuti*, 639 F.2d 107 (2nd Circ. 1981) "persuasive." (Although noting that part of *Mennuti's* holding [as to rental properties] had been superseded in *Russell v. United States* (1985) 471 U.S. 858). *Jones, supra,* 529 U.S. at 854, n.6.)

In *Mennuti* the Court stated:

> Consequently a residence is not used in interstate or foreign commerce simply because it was built in part with out-of-state materials, its purchase was financed by a bank which engages in or whose activities affect interstate commence, it was insured by a company engaged in such commerce, it received electric power and telephone service from companies engaged in or affecting commerce, and its repair or reconstruction will require out-of state materials.

Mennuti, supra, 639 F.2d. at 110.

In the instant case, any interstate activity had ceased by the time the problems were revealed and the lawsuit filed. The homes are not going anywhere, certainly not out of state. *See, Aronov Realty v. Morris* (2002) 2002 Ala. LEXIS 129, 23-25 (upholding denial of

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[6] In fact, the dissent in *Lopez* specifically recognized that the *Lopez* holding could cast uncertainty in areas of law, including criminal statutes such as 18 U.S.C. §844(i), which use the words "affecting commerce" to define their scope.

motion to compel arbitration under FAA as to residential real property due to absence of substantial effect on interstate commerce noting: "The defendants cannot escape the fact that Morris' condominium unit is incapable of moving across state lines.") The subject dispute does not "substantially affect" interstate commerce because the transactions at issue occurred ***after*** interstate involvement was completed, and do not involve ongoing interstate commerce. Thus, federal preemption pursuant to the FAA is an invalid application of federal law.

B. Any Connection with Interstate Commerce is Lacking or so Attenuated That the Power of Congress to Regulate this Contract Cannot be Utilized

Under the Court's latest rulings, the distinction between "indirect" or remote transactions is still viable, and, as noted by the *Lopez* Court, is consistent with Commerce Clause jurisprudence. *Lopez, supra*, 514 U.S. at 557 (citing *Jones & Laughlin, supra*, 301 U.S. at 37, emphasis added).

A.L.A. Schecter Poultry Corp. v. United States, 295 U.S. 495 (1935), is noted for the second prong of its analysis: the utilization of a distinction between "direct" and "indirect" relationships to commerce, and the finding that since there was no "direct relationship" between the intrastate poultry transactions with interstate commerce, the transactions were not subject to federal regulation. The Court's rejection of the concept of an "indirect" relationship to commerce as a basis for the regulation was in reaction to the Government's argument that a slaughterhouse operator's paying lower wages "results in demands for a cheaper grade of goods, and that the cutting of prices brings about a demoralization of the price structure." *Id.* at 548-549. No such considerations are present in

the instant matter. Once the homes were sold, the activity and transaction were complete. There were longer any direct ***or*** indirect results on interstate commerce.

Only two years after *Schecter,* the Court reversed course, and in *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1, 81 (1937) the Court rejected the distinction between "direct and indirect," and, five years later, set forth the most expansive interpretation of power under the Commerce Clause, in *Wickard v. Filburn,* 317 U.S. 111 (1942), arriving at the "substantially affecting commerce" test. *Id.* at 125.

However, as pointed out by Justice Kennedy in *Lopez,* the "direct/indirect" analysis is still viable, albeit in a narrower sense:

> [E]ven these modern-era precedents which have expanded congressional power under the Commerce Clause confirm that this power is subject to outer limits. In *Jones & Laughlin Steel,* the Court warned that the scope of interstate commerce power must be considered in the light of our dual system of government and may not be extended so as to embrace effects upon interstate commerce ***so indirect and remote*** that to embrace them, in view of our complex society, would effectually obliterate the distinction between what is national and what is local and create a completely centralized government. *Lopez, supra,* 514 U.S. at 557 (citing *Jones & Laughlin, supra,* 301 U.S. at 37, emphasis added).

Rejecting the concept of finding a remote, attenuated relationship as constituting a basis for federal regulation, the Court in *Lopez* emphasized the *"substantial"* aspect of the test, as opposed to using a "relatively trivial impact on commerce as an excuse for broad general regulation of state or private activities."

Lopez, supra, 514 U.S. at 559. *See, L & L Kempwood v. Omega Builders* (1998) 972 S.W. 819, 821 (holding that the "affecting commerce" test in *Allied-Bruce Terminix Cos. v. Dobson* (1995) 513 U.S. 265, 273-274, did not survive *Lopez*'s articulation of a "substantially affecting" commerce test.)

The Court in *Lopez*, therefore, rejected the argument in the dissent that "the threat of firearm possession near schools poses threats to the educational process and the potential economic consequences flowing from that threat....This analysis would be equally applicable, if not more so, to subjects such as family law and direct regulation of education." *Id.* at 565. [And thus, equally to regulation of housing and construction, similarly distinctly local concerns]. *See also Morrison, supra*, 529 U.S. at 612, emphasizing the fact that the *Lopez* decision rested in part on the fact that a link between gun possession and a substantial effect on interstate commerce was attenuated.

In the case of the contract for sale of a completed owner-occupied residence, there is not even an attenuated or remote or indirect link between the transaction and interstate commerce. The purpose of the FAA is to ensure that arbitration provisions in contracts involving interstate commerce are enforced just as any other contract provisions. *Volt, supra*, 489 U.S. at 474. When there is no link between a contract and interstate commerce, this concern is not in issue, and the application of the FAA to enforce the arbitration clause in contravention of state law, which would render such a provision unenforceable, is invalid.

II. THE PRINCIPLE OF *STARE DECISIS* SHOULD NOT PRECLUDE THIS COURT FROM RE-EXAMINING ITS DECISIONS IN *SOUTHLAND V. KEATING* AND *ALLIED BRUCE V. TERMINIX*

A. The Legislature Did Not Intend the FAA to be Applied to Cases in State Court Actions. Thus the Decisions in Southland and Allied-Bruce Should Not Preclude This Court From Reversing Its Position.

The Court first squarely tackled the question of whether the FAA was applicable in state court actions in *Southland Corp v. Keating*, 465 US 1(1984), holding in the affirmative, by a decision in which five justices joined, one, Justice Stevens, concurred and dissented, and Justice O'Connor wrote a strong dissent, joined by Justice Rehnquist.

This holding was re-examined, in *Allied Bruce v. Terminix*, 513 U.S. 265 (1994), where a divided court re-affirmed the holding. The dissents set forth an exhaustive analysis of the Court's Commerce Clause jurisprudence, as well as a detailed study of the legislative history of the Federal Arbitration Act, demonstrating that the drafters of the Act never intended that it be applicable to actions in state courts. Perhaps the most telling factor is that the enforcement mechanism, set forth in 9 U.S.C.§§ 3 and 4, refers specifically to actions to take place ***in federal district court.*** *Id.* at 848 (Thomas, J., dissenting).

In re-iterating her position, Justice O'Connor made her position clear as to the legislative intent:

> "Yet over the past decade, the Court has abandoned all pretense of ascertaining congressional intent with respect to the Federal Arbitration Act, building instead, case by case, an edifice of its own creation. See *Perry v. Thomas, supra*, at 493 (Stevens, J., dissenting) ('It is only in the last few years that the Court has effectively rewritten the statute to give it pre-emptive scope that Congress certainly did not intend').
>
> * * *

> Today's decision caps this Court's effort to expand the Federal Arbitration Act. Although each decision has built logically upon the decisions preceding it, the initial building block in *Southland* laid a faulty foundation.

Id. at 284 (O'Connor, J., concurring)

Justice Scalia, in dissenting in *Allied Bruce*, remarked: "I shall not in the future dissent from judgments that rest on *Southland*. I will, however, stand ready to join four other Justices in overruling it, since *Southland* will not become more correct over time . . . . *Id.* at 285. (Scalia, J., dissenting).

As set forth below, the decision has become even *less* correct over time. It is respectfully requested that the Court accept Justice Scalia's invitation, and reverse the holding in *Southland*.

B. The Principle of *Stare Decisis* Should Not Preclude the Court From Re-Examining its Position.

1. *Stare Decisis* Should Not be Controlling When Earlier Decisions Were Erroneously Decided.

As set forth above, analysis of the legislative intent of the drafters of the FAA does not support the position set forth in *Southland*. As the Court stated in *Smith v. Albright*, 321 U.S. 649 (1944), the Court should not feel compelled to adhere to an erroneous position: "However, when convinced of former error, this Court has never felt constrained to follow precedent. . . . This is particularly true when the decision believed erroneous is the application of a constitutional principle rather than an interpretation of the Constitution to extract the principle itself. *Id.* at 666.

2. *Southland* and Its Progeny Have Created Problems Both for the Courts and for Consumers, Such That *Stare Decisis* Should Not Control.

The Court is not required to adhere to precedent when the previous decision has proved problematic. As stated in *Swift & Co. v. Wickham*, 382 U.S. 111, 116 (1965), "We believe that considerations of *stare decisis* should not deter us from this course. Unless inexorably commanded by statute, a procedural principle of this importance should not be kept on the books in the name of *stare decisis* once it is proved to be unworkable in practice; the mischievous consequences to litigants and courts alike from the perpetuation of an unworkable rule are too great."

The Court in *Allied-Bruce Terminix Companies, Inc. v. Dobson* 513 U.S. 265 (1995), in re-affirming the holding in *Southland*, relied on the principle of *stare decisis*, and, without any supporting data, upon the propositions that (1) *Southland* is working just fine; and (2) that parties have likely relied on *Southland* in drafting their contracts, such that *Southland* should not be reversed:

> Nothing significant has changed in the past 10 years [since the decision in *Southland*]; no later cases have eroded *Southland*'s authority; and no unforeseen practical problems have arisen.[7] Moreover, in the interim, private parties have likely written contracts relying upon *Southland* as authority.

Id. at 272. see also concurring opinion by Justice O'Connor: "Though wrong, *Southland* has not proved

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[7] The very fact that attorney-general from 20 states submitted amicus briefs supporting the reversal of *Southland*, a fact that is mentioned in the very same paragraph, seems to contradict this contention.

unworkable." *Id.* at 284.

Neither of these propositions are tenable. It is respectfully submitted that the Court should re-examine its holding in *Southland.*

i. Recent Developments Justify Re-Examining *Southland.*

It is respectfully submitted that the first proposition is not based on a realistic assessment of the practical impact of the decision, especially in regard to actions regarding contracts for purchases of new development homes. Furthermore, to the extent that it reflected the situation in 1995, developments since that time demonstrate that *Southland* has created practical problems for state courts seeking to reconcile *Southland* and later Supreme Court Commerce Clause decisions with state law provisions seeking to protect consumers [and in the case of California, specifically home purchasers] from the effects of adhesive, and, in many cases, unconscionable contracts drafted by agents of large businesses.

Specifically, at least three subsequent Court Commerce Clause decisions have created confusion in the state courts regarding the application of *Southland*: *United States v. Lopez*, 514 U.S. 549 (1995); *United States v. Morrison*, 529 U.S. 598 (2000); and *Doctor's Associates, Inc. v. Casarotto* (1996) 517 U.S. 681.

The curious odyssey involved in the eventual decision in *Doctor's Associates* provides the clearest example of this confusion. First, the Montana Supreme Court held that a state law provision mandating certain notice requirements for an arbitration clause was unenforceable pursuant to the FAA, relying on *Volt Information Systems, Inc. v. Trustees of Leland Stanford Junior University,* 489 U.S. 468 (1989). The Supreme Court granted certiorari and remanded it back to the

state court for reconsideration in light of its decision in *Allied-Bruce*. *Doctor's Associates,* 515 U.S. 1129. The Montana Supreme Court reconsidered it in light of *Allied-Bruce* and *Volt Information Systems, Inc. v. Trustees of Leland Stanford Junior University,* 489 U.S. 468 (1989), but adhered to its previous decision, finding no preemption under the FAA. *Casarotto v. Lombardi,* 901 P.2d 596 (Mont. 1995). This led to the eventual return to the United State Supreme Court and the decision in *Doctor's Associates, supra,* 517 U.S. 681, holding that the notice provisions were invalid, as they were special requirements applicable to arbitration clauses only. *Id.* at 687.

Likewise, *Lopez* and *Morrison*, the first cases in over 60 years to invalidate a federal statute on Commerce Clause grounds, have added another wrinkle to state court analysis in trying to reconcile the appropriate standard to apply in deciding whether a particular contract "involves" interstate commerce. See discussion in *Basura v. U.S. Home Corp.* 98 Cal.App. 4th 1205, 1213, n. 8, comparing, *Palm Harbor Homes, Inc. v. McCoy*, 944 S.W. 2d 716 (1997) (applying *Allied-Bruce* "commerce 'in fact'" test) and several other cases with *L & L Kempwood v. Omega Builders,* 972 S.W. 2d 819 (1998) "(holding *Allied Bruce's* 'affecting commerce' test did not survive *Lopez's* articulation of a 'substantially affecting' commerce test.)"

ii. Purported Reliance on *Southland* Does Not Justify Continued Adherence to This Decision.

The second proposition is that parties to contracts have relied on *Southland.* Regrettably, this is true. However, the reliance is one-sided. "Parties," consisting of defendant businesses, and in particular developers and sellers of new home development projects have

certainly relied on *Southland*, and mandatory alternative dispute mechanisms in drafting their contracts. Home buyers do not draft contracts. Nor do they generally have any meaningful ability to negotiate them. Examples of the adhesive nature of contracts involved in purchases of homes in development projects, and developers' multi-pronged attacks on homebuyers' rights to pursue their actions in a court of law are legion. As examples, just in California alone, see: *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal.App. 4th 819 (2000) (attempt to enforce arbitration clause in Covenants, Conditions and Restrictions); *Pardee Construction Co. v. Superior Court*, 100 Cal.App. 4th 1081 (2002). (attempt to enforce clause requiring to judicial reference found to be unconscionable. The court commented that "at oral argument both counsel represented that significant portions of construction defect cases are already commonly sent to judicial reference." *Id.* at 1091.) The court found it significant that none of the potentially 800 sets of class members struck out the judicial reference section, finding that the developer, Pardee, had effectively admitted that they were contracts of adhesion. The court rejected Pardee's argument that plaintiffs "'can go elsewhere if they don't like it'" as "'fly[ing] 'in the face'of the uniqueness of a home.") *Id.* at 1087.

Southland and its progeny have not simplified matters for the state courts, at least in the context of construction defect cases. Now, rather than relying on state legislation designed to protect homebuyers, the courts, faced with persistent demands by corporate and business defendants to compel arbitration, are required to conduct fact intensive investigations into the conscionability of alternate dispute resolution provisions. See *Doctor's Associates, Inc. v. Casarotto* (1996) 517 U.S. 681, 686-687. '[G]enerally applicable contract defenses, such as fraud, duress or unconsciousability, may be applied without

contravening § 2 [of the Federal Arbitration Act.]"

Furthermore, as Justice Scalia noted: "Abandoning [*Southland*] does not impair reliance interests to an extent that justifies this evil," noting that a remedy would be available through rescission, if it were a problem. *Allied-Bruce, supra,* 513 U.S. at 285 (Scalia, J., dissenting).

Any "reliance by the parties," thus, does not constitute ample justification for adhering to the faulty analysis of legislative intent set forth in *Southland.* It is respectfully submitted that it should be reversed.

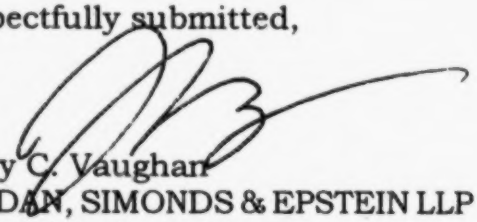
CONCLUSION

The Petition for Writ of Certiorari should be granted for two compelling reasons: First, to delineate the scope of the Commerce Clause as it relates to contractual action involving defects in new residential housing under the Court's emerging Commerce Clause jurisprudence. It is respectfully submitted that the Court should clarify that the provisions of the FAA are not applicable in these transactions, which involve scores of new home buyers nationwide and clarify that preemption under the provisions of the FAA is invalid in such application.

Second, it is also respectfully submitted that there are compelling reasons to re-examine *Southland Companies, Inc. v. Keating,* and reverse its holding as to application of the provisions of the FAA in state court actions.

For these, and the other foregoing reasons set forth, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,



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